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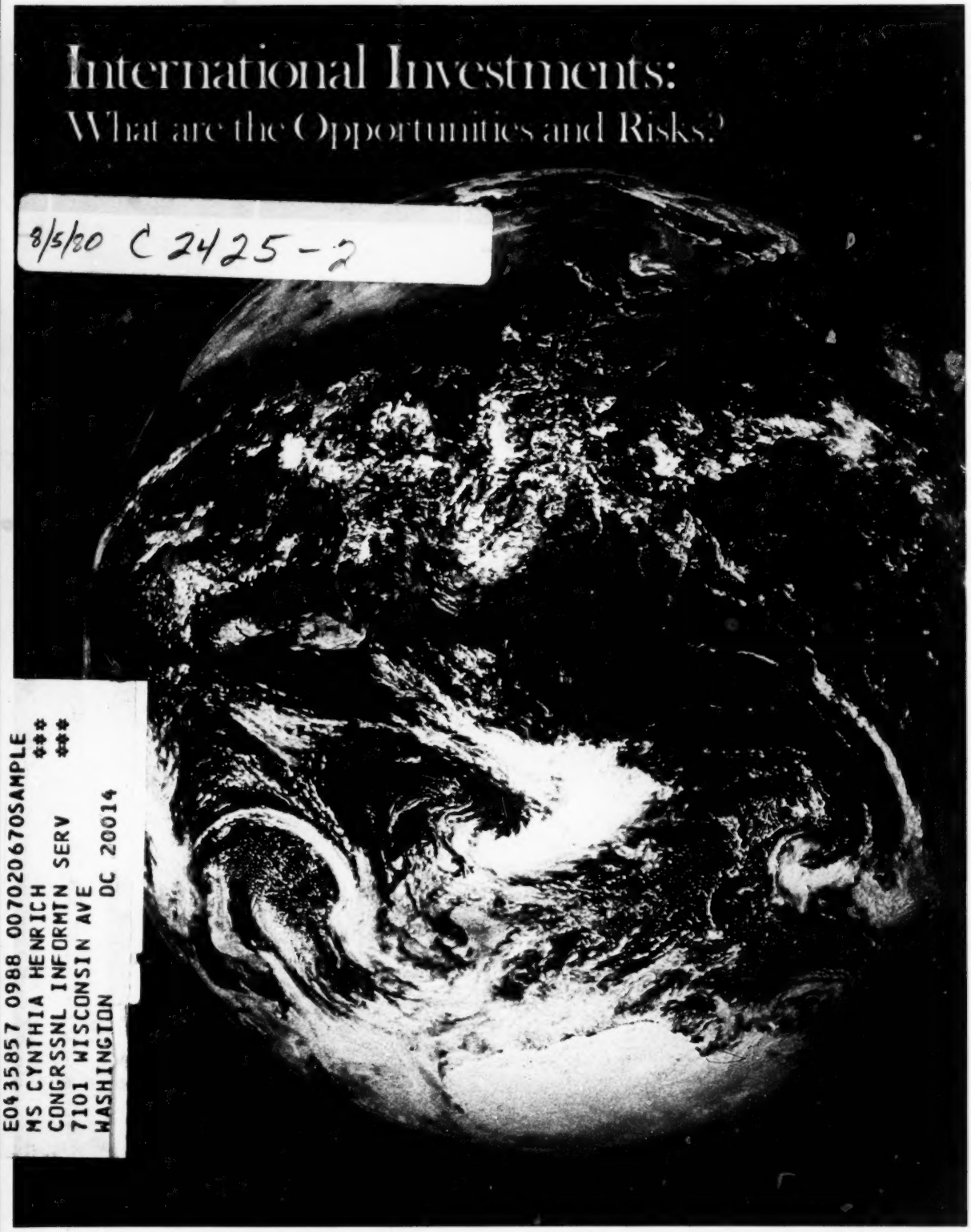
ESTATE PLANNING & ADMINISTRATION
A Publication of Communication Channels, Inc. AUGUST 1980

International Investments:
What are the Opportunities and Risks?



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COVER

This month's cover features a spectacular view of the earth to illustrate the theme of international investments. Apollo 17 Astronaut Ronald E. Evans took the photograph as he and Astronauts Eugene A. Cernan and Harrison H. Schmitt traveled toward the moon. The photograph comes to us courtesy of the National Aeronautics and Space Administration.

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International Equity Management

Turning to overseas markets can reduce risks for some American investors

by LANDON THOMAS
Executive Vice President
Fiduciary Trust Company
New York, N.Y.

Landon Thomas joined Fiduciary Trust Co. of New York in 1960. He was elected a vice president in 1966 and was named executive vice president in charge of the international department in 1968. He was elected to the bank's board of directors in 1976.

Thomas was graduated from Harvard University and did post-graduate work at Centre d'Etudes Industrielles in Geneva.

American investors have shown little interest in portfolio investment outside their own country. This is not surprising in view of the tremendous economic strength and market opportunities available in the United States. The American investor, with every conceivable investment vehicle at his disposal, is immersed in a surfeit of statistics and information of all kinds and can rely on the SEC to protect him from some of the less obvious hazards of investing.

The interest equalization tax, introduced in 1963 and continuing until 1974, effectively put all thought of direct international investment diversification out of the minds of U.S. investors. Still, the typical American individual and institutional account has long been invested in multi-national corporations and most of these companies are well managed and have developed profitable markets around the world. To this extent the investor has been introduced to opportunities abroad.

There are many advantages for the investor through a direct international approach to investment management, and one of the most important is reduction of risk.

International diversification should be viewed first from the defensive. It is important to avoid undue risk. Aside from the fact that diversification always has been prudent, it can be demonstrated, again with indicies, that over the past 10 years, an internationally diversified portfolio has resulted in less volatility than one limited to a particular national market.

Chart 1 demonstrates these points. A line representing an imaginary account, 70 percent of which has been invested arbitrarily in the S&P 500 index and the remaining 30 percent in the Capital International Europe, Australia and Far East index, has been superimposed on the domestic and international indicies. The diversified account, following the blue line, generally is less volatile than either of the two indicies over the 10-year period.

Capital International S.A., to whom the authors are indebted for many of the accompaning charts, is an established group based in Geneva and whose indicies are broadly accepted throughout the world. The Capital International Europe, Australia and Far East index is an arithmetical average weighted by market value of some 450 companies representing 12 European countries. The market value of the companies included in this index was $434 billion as of March 1, 1980. We will have further reference to the service.

Incremental Return

A second important consideration is the incremental return from international investment.

There is no doubt that, based on a comparison of indicies, a higher return over a 10-year period has been obtained by portfolio investment overseas. In spite of the alternative of a passive approach through index funds, the Fiduciary Trust Co. believes that careful portfolio management still can produce better results over a reasonable period of time. Chart 2 demonstrates this by a comparison of domestic and international indicies — in local currency and dollars — with the Fiduciary non-U.S. aggregate performance.

Diversification is the essence of prudent portfolio management. If it is

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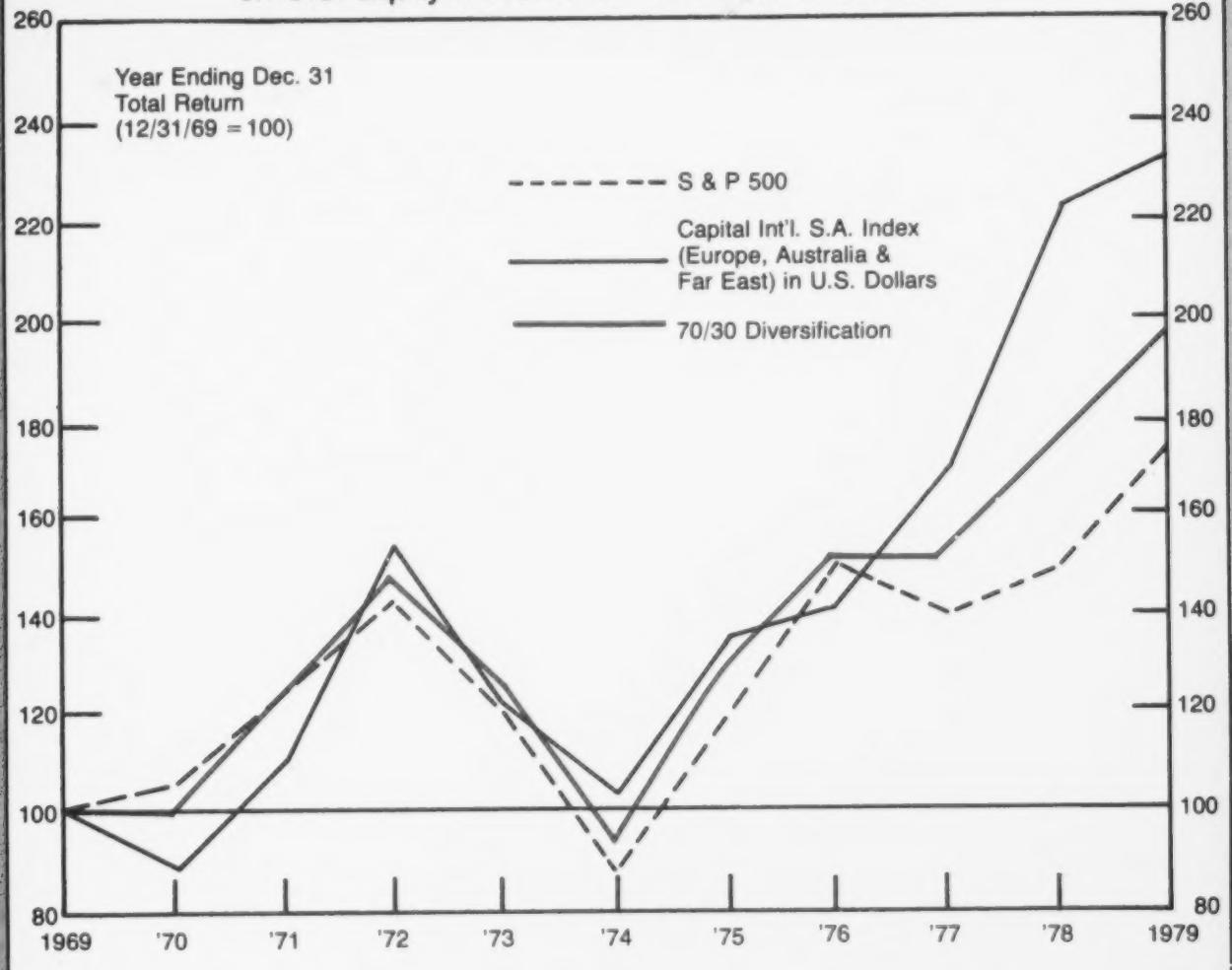
CHART 1

Effect of International Diversification on U.S. Equity Investment — 30 Percent Non U.S.



ANNUAL % CHANGE	70	71	72	73	74	75	76	77	78	79	10YR.
70/30 DIVERSIFICATION	(0.9)	19.3	24.2	(14.5)	(25.5)	36.7	17.6	0.5	14.4	14.5	7.0
CAPITAL INT'L. S.A. INDEX (EUROPE, AUSTRALIA & FAR EAST) IN U.S. DOLLARS	(12.2)	30.4	36.3	(14.9)	(23.2)	35.4	2.5	18.1	32.6	4.7	8.8
S & P 500	3.9	14.3	19.0	(14.7)	(26.5)	37.3	24.0	(7.1)	6.6	18.5	5.9

wise to invest among industries, companies and even different securities of one company in the United States, it is logical to consider the same choices in other free-enterprise economies. Furthermore, the willingness and ability to evaluate political and economic conditions in other countries can be useful even to the investor limited to the United States.

It is of paramount importance to select and emphasize those markets which promise the best returns combined with historically low volatility and with little correlation to market indicies in the United States.

Don't Become Too Concerned

Once a position has been taken on the outlook for a country's economy and the conclusion is at least moderately positive, it is important not to become too concerned with the uncertainties — both political and economic — which always come to mind when peering into a neighbor's backyard.

In Fiduciary's experience, the best approach to international investment is through careful study of an industry's future within its domestic market and in a worldwide context. Careful research analysis of every individual investment is the final step in the decision-making process.

Most of the same analytical and portfolio standards are applied to non-U.S. investments that are applied to stock selection in the U.S. Balance sheet and earnings considerations are essentially the same. Regulatory problems are given equal weight and cyclical aspects are evaluated as they are in

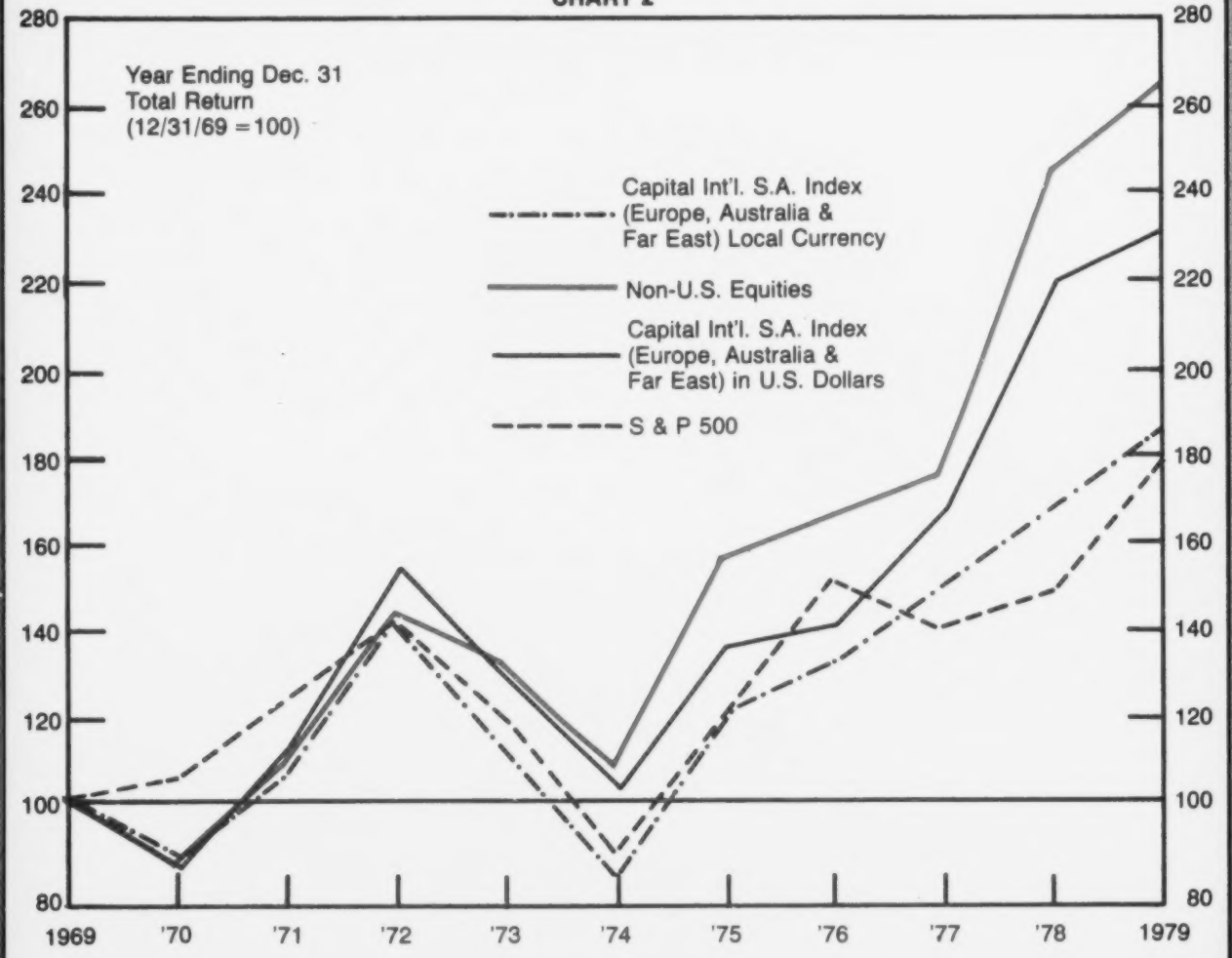
every institution on Wall Street.

The one important difference is that stocks are chosen with the alternative U.S. value very much in mind. There is no reason to search for high technology in data processing if it is clear that IBM remains a world leader. On the other hand, if an equity investment in another country can provide participation either in an industry or in a company which measures favorably with the opportunities in the U.S., there is every reason to consider such an investment favorably.

A good example in recent years has been high-technology companies in Japan, particularly the semi-conductor industry. Based on highly successful proprietary research and development, Japanese companies have captured an increasing share of world markets and now compete effectively with industry giants in the United States.

Australia offers by far the best opportunity for investment in minerals. The country is a high-grade, low-cost producer and the mining sector is based on the rapidly growing and resource-hungry economies of the Pacific Basin. Western Mining is the world's fourth largest producer of nickel with a profitable exposure to gold and aluminum.

CHART 2



ANNUAL % CHANGE	70	71	72	73	74	75	76	77	78	79	10YR
NON-U.S. EQUITIES	(10.8)	23.5	30.0	(8.8)	(18.8)	49.6	6.7	6.0	36.3	7.9	10.2
S & P 500	3.9	14.3	19.0	(14.7)	(26.5)	37.3	24.0	(7.1)	6.6	18.5	5.9
CAPITAL INT'L. S.A. INDEX (EUROPE, AUSTRALIA & FAR EAST) IN U.S. DOLLARS	(12.2)	30.4	36.3	(14.9)	(23.2)	35.4	2.5	18.1	32.6	4.7	8.8
CAPITAL INT'I. S.A. INDEX (EUROPE, AUSTRALIA & FAR EAST) LOCAL CURRENCY	(11.6)	18.4	35.8	(20.4)	(24.4)	42.2	5.3	4.7	14.9	9.4	6.2

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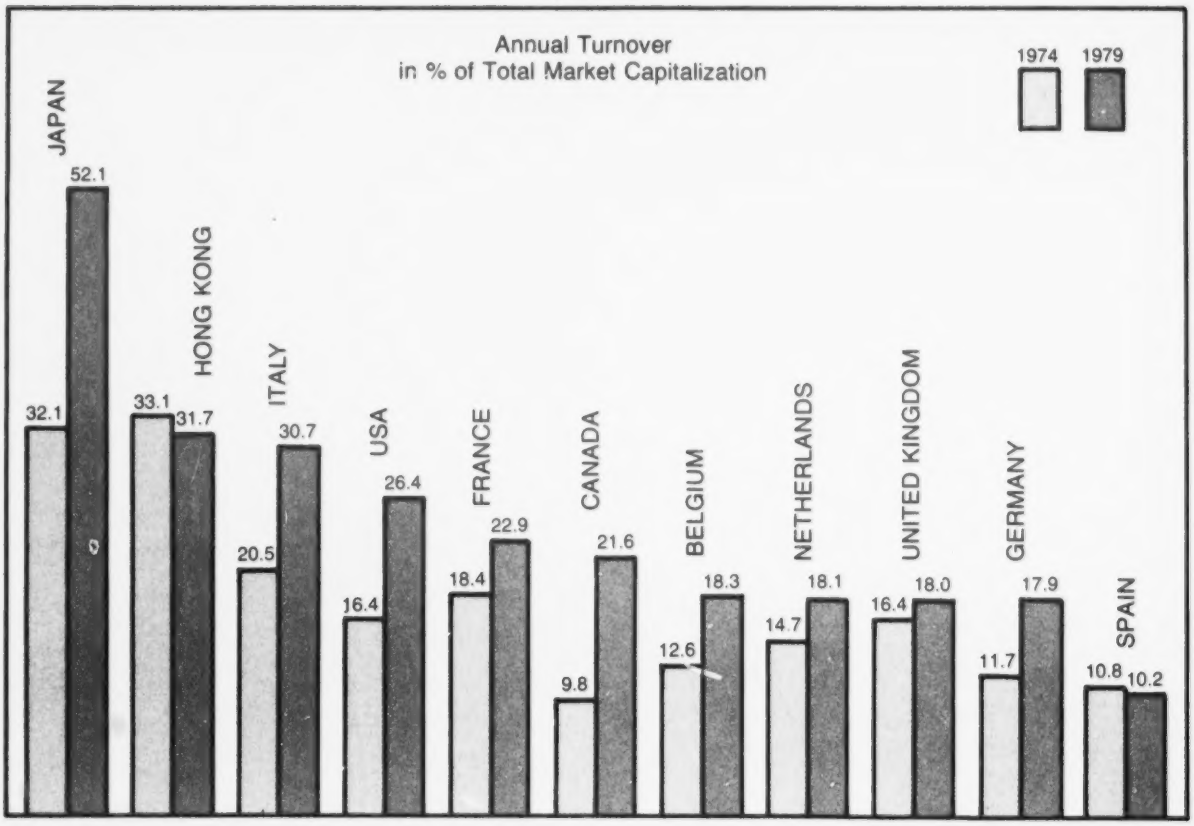
CHART 3



Note: Turnover data refers to common stocks only It includes foreign shares listed, except in Germany and the Netherlands.
Capital International Perspective 3'80 Geneva Switzerland

Although results are dependent largely on demand for nickel, the company has huge underdeveloped prospects for uranium and copper. Compared to International Nickel, a far larger and more mature company, Western Mining is a logical choice.

Broken Hill Proprietary (BHP) is a unique investment in many ways. Aside from being the largest integrated steel company in Australia — the division also is profitable — BHP is an excellent natural resource company with heavy and extremely profitable emphasis on oil and natural gas. Over the longer term the company's interests in coal, maganese, iron ore, tin and gold offer considerable potential as well. In this case, there are no alternative invertments offering such a diversified spread of natural resources. (Table 1)

Fiduciary historically has emphasized the financial sector outside the United States. Insurance stocks overseas have performed well on a comparative and absolute basis. Industry leaders have dominated their domestic markets and aggressively taken on profitable international risks. Results have been relatively free from the traditional underwriting cycles and there has been every incentive for the international investor to emphasize companies such as Nationale Nederlanden and Tokyo Marine. (Table 2)

"Insurance stocks overseas have performed well on a comparative and absolute basis."

There are many similar examples farther afield. For those who are looking for a fairly undiluted investment in the prospects for North Sea oil, Petrofina, a Belgium-based company, should be measured carefully against the various international oil companies with interests in that part of the world. Norsk Hydro, although basically a cyclical chemical/metal company, has a significant interest in proven reserves in the Norwegian sector. Oil and natural gas earnings should have a tremendous impact on overall earnings.

The process of weighing alternatives also should be extended to industries. In the recent past the problems of the U.S. banking industry have been very much in evidence and the stocks of many of these companies have not been in favor.

The banking industry in many countries overseas, while certainly affected by some of the difficulties besetting U.S. banks, have been in an essentially better position. The German universal banks operate in an entirely different banking system and can engage profitably in many areas of financial opportunity from which U.S. banks have been excluded for a long time.

In Southeast Asia, it is even possible to invest in a bank which performs essentially the function of a central

Table 1

Natural Resources	1975	1976	1977	1978	1979	5-year
			Local Currencies			
Broken Hill Proprietary	+38%	+11%	−21%	+55%	+58%	+198%
Western Mining	−12	+11	−22	+41	+74	+ 87
International Nickel	+ 7	+ 9	−48	− 3	+51	+ 10

bank. Both the earnings and stock market prices, even in local currencies, of these banks over the past five years have far outperformed their American equivalents. (Table 3)

Liquidity is highly important and there has been much criticism of the lack of it in overseas markets. The worldwide economic domination of the U.S. is reflected in the market capitalization of other countries. The Capital

Table 2

Insurance	1975	1976	1977	1978	1979	5-year
			Local Currencies			
Nationale Nederlanden	+75%	− 2%	+22%	+11%	−14%	+165%
Tokyo Marine	+19	+38	−13	+ 1	+40	+102
Aetna Life & Casualty	− 1	+51	+ 3	+ 6	−14	+ 43
General Reinsurance	−12	+25	−11	+ 4	+10	+ 12
A.I.G.	+20	− 5	+ 7	+22	+17	+ 74

International figures clearly show that the bulk of the investments of an internationally invested portfolio should be in the United States.

Great Majority U.S. Based

The fact that the great majority of investments of the ideal portfolio should be U.S. based cannot be overlooked. To some extent, the schedule in Table 4 suggests a rough guideline to the limits of the commitments that could be made around the world.

Measured on market capitalization, the difference is huge between the U.S. and, say, the Netherlands and Hong Kong. On the basis of that measurement alone, it would be easy to exclude any investment in these countries. Using a different measurement — that of a turnover in percent of total market capitalization — the situation appears in a more favorable light (Chart 3).

The conclusion would be that turnover in other markets is not out of line with United States markets.

Liquidity considerations in other markets do not necessarily dictate investment emphasis. There is just as much potential risk in other diversification in the U.S. equity markets as there is in needless investment concentration in overseas markets. Neither extreme is necessary.

Suitable investments are available in other markets and a portfolio can be spread broadly while still concentrating on companies which offer better rewards. Fiduciary Trust Co. places investment emphasis on companies of particular interest. Of some 90 issues in the aggregate non-U.S. portfolio, the 20 largest holdings amount to just over 40 percent of the total market value.

There can be no doubt that liquidity always will be a problem for investors, not only in markets overseas, but also in all equity markets when buyers are hard to find.

Since the end of 1970, floating currencies have beome a part of international financial transactions. They not only concern corporate treasurers, but also the international portfolio investor. Currency regulations alone must not rule the investment decision-making process. The strength or weakness of a currency is important and will have an affect on any investment, but it still is essential to evaluate the fundamental prospects of an industry and a company.

Once satisified as to the basic value of an equity investment, one can properly put it into the context of the home country's current economic situation. It is comforting to observe that the economic management of a country still is the main factor influencing the fluctuations of its currency.

Currency values will reflect the basic health of a national economy over the longer term, and this has held true as monetary systems have come and gone. If the fundamental merits of the economy, industry and company have been judged correctly, the currency sooner or later will take care of itself.

The situation of the U.K. in 1974 demonstrates the risk in basing investment decisions on currency considerations alone. At the end of 1974, there was general agreement that pound sterling was overvalued at £ = $2.35. At the same time the Financial Times index stood at 161 after a violent drop over the preceding months. By the middle of December, 1977, pound sterling conveniently had justi-

Table 3

Banks	1975	1976	1977	1978	1979	5-year
			Local Currencies			
Deutsche Bank	+ 35%	−18%	+ 8%	+ 3%	−13%	+ 10%
Dresdner Bank	+ 52	−12	+ 7	+ 2	−20	+ 17
Algemene Bank	+ 38	+ 4	+13	+17	− 7	+ 75
Amro Bank	+ 30	− 5	0	+16	− 5	+ 36
Hongkong & Shanghai Bank	+145	+25	− 8	+10	+65	+411
Union Bank of Switzerland (bearer)	+ 74	+ 8	+ 6	− 6	+16	+117
Development Bank of Singapore	+ 87	+26	− 9	+12	+32	+217
Malayan Bank	+ 60	+41	−16	+36	+32	+352
National Westminster	+145	− 7	+25	− 1	+25	+252
Morgan (J.P.)	+ 3	+ 5	−24	+ 6	+ 2	− 8
Citicorp	+ 4	+11	−30	+ 3	+ 1	− 9
Chase	+ 2	+11	− 2	− 2	+31	+ 43
First Chicago	+ 5	+28	−19	+ 3	−16	− 10

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fied the suspicions of all concerned by a fall of 24 percent to £ = $1.90.

Unfortunately for those who had correctly foreseen the pound's fall, and on that basis sold U.K. equities at the end of the 1974 year, the recovery in the Financial Times index of 201 percent to a level of 485 at the end of 1977 would have been missed.

Currency Considerations

Currency considerations, while part of the investment process, should be taken in their proper context. The effect of currency fluctuations on portfolios reporting in U.S. dollars can be significant in any given year, but over a longer period of time the difference is not extraordinary.

In Chart 2, the Capital International Europe, Australia and Far East index, as expressed in local currencies, compares with the solid black line which represents the performance of the index after conversion to U.S. dollars. The currency gain accruing to investors who benefited from the relative strength of local currencies was important, but should not obscure the strong growth of the index in local currency terms.

Two of the many other factors that the prospective international investor should consider will serve to round out the picture. The question of corporate information, or lack of it, often has been raised and now can be answered with far more conviction than was possible 10 or 15 years ago.

Corporate reporting precedures have improved greatly around the world and there have been a number of moderately successful attempts to introduce market supervision and controls. In every country of investment interest there are many excellent financial institutions which have become more and more familiar with worldwide portfolio investment.

Fiduciary has found that with the help of long-standing correspondent friends in countries where we are engaged, we never have suffered a serious shortage of corporate information. We always have been able to conduct our own independent basic research analysis on any country in which we have a commitment.

There generally is no difficulty in gaining access to management and corporations which have become far more conscious of investor relationships.

Administration and reporting also should not be overlooked. It is vital to any successful investment program, no matter where, to have established an efficient custodial, administrative and reporting system. Fiduciary has had no difficulty in establishing such systems with the help of leading financial institutions around the world. It is entirely possible to produce investment appraisals in a format consistent with the demands of American individual and institutional investors.

This article may serve as an introduction to investors who would like to consider international diversification as a prudent means towards achieving a higher return and significantly reducing risk. If the program sounds complicated, the first step might well be to diversify the bond section of a U.S.-invested portfolio. The incremental returns can be measured in basis points, proven statistically, and there is no language problem with numbers. □

Table 4

Capital International Indices

(as of March 31, 1980)

	Companies Included in Indices					
	Number	Market Capitalisation	Europe	E.A. & F.E.	World	Market Coverage of Indices
U.K.	105	$ 90.9 bill.	38.4%	20.9%	9.2%	64.3%
Germany	67	47.4 bill.	20.0	10.9	4.8	69.8
France	78	27.2 bill.	11.5	6.3	2.8	57.5
Spain	20	7.6 bill.	3.2	1.8	0.8	47.7
Switzerland	28	23.3 bill.	9.8	5.4	2.4	61.7
Netherlands	22	16.0 bill.	6.8	3.7	1.6	79.2
Italy	43	7.7 bill.	3.3	1.8	0.8	58.0
Belgium	26	7.1 bill.	3.0	1.7	0.7	68.0
Sweden	22	4.9 bill.	2.1	1.1	0.5	48.8
Denmark	15	1.4 bill.	0.6	0.3	0.1	47.3
Norway	10	1.8 bill.	0.8	0.4	0.2	80.4
Austria	9	1.3 bill.	0.5	0.3	0.1	65.0
Europe	445	$236.6 bill	100.0%			63.7%
Japan	191	158.7 bill.		36.5	16.1	60.6
Hong Kong	20	11.5 bill.		2.6	1.2	58.6
Singapore	36	5.7 bill.		1.3	0.6	41.2
Australia	64	21.7 bill.		5.0	2.2	56.9
Europe Australia & Far East	756	$434.2 bill.		100.0%		61.6%
U.S.A.	268	490.3 bill.			49.9	54.8
Canada	60	49.6 bill.			5.0	51.5
South African Golds	23	9.6 bill.			1.0	45.6
World	1,107	$983.7 bill.			100.0%	57.3%

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NOTE

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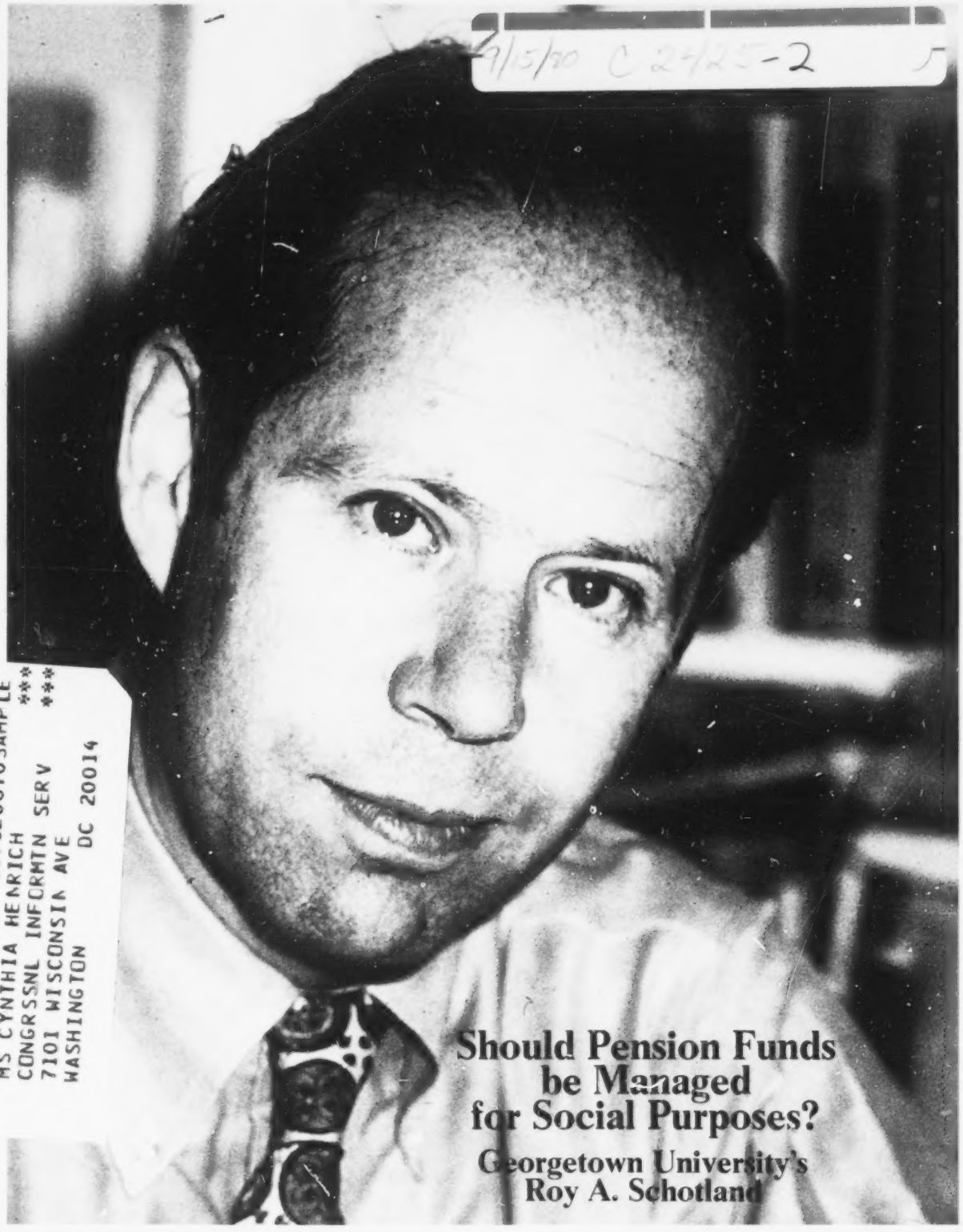

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Should Pension Funds be Managed for Social Purposes?

Georgetown University's Roy A. Schotland

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TRUSTS & ESTATES

Volume 119, No. 9 SEPTEMBER 1980

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COVER

Our cover story this month is the first in a three-part series by Roy A. Schotland, professor of law at Georgetown University Law Center, Washington, D.C. Schotland explores the question: Should pension plans be managed for social purposes as well as to insure the security of their beneficiaries? (Photo by Walter H. Sonnenfeldt)

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First of Three Parts

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Should Pension Funds be Used to Achieve "Social" Goals?

by ROY A. SCHOTLAND
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One of those more-heat-than-light issues is "social investing," the question of whether pension funds should diverge from their traditional goal of maximizing investment return at an appropriate level of risk in order to pursue other goals.

Analysis suffers from the outset if the label "social" or "socially responsible" investing is accepted. Few minds will be open to any plea for the anti-social or irresponsible, and hardly any more will think "let the market decide" a sufficient answer. But further, the "social" label is over-broad. Everyone agrees that investing for retirement security itself is a socially responsible goal. More accurate labels would be "alternative" or "divergent" investing, since the proposal is to tap pension assets for goals other than retirement security.

Some advocates of alternative or divergent investing do not go so far as to advocate any step — whether it would involve seeking out favored investments, or avoiding disfavored ones — which might impair a pension fund's pursuit of protecting retirement security. Other advocates are prepared to diverge quite openly from the traditional exclusive primacy of retirement security.

Whatever the label, surely it sounds attractive to invest both to protect retirement security and to promote such other goals as equal employment opportunity, or environmental quality, or local jobs or housing. If "Investment XX" has as high a return and low a risk as other clearly appropriate investments, but XX also promotes common concerns of the pension fund's beneficiaries, then the only investment manager who wouldn't buy XX for that fund would be a misanthrope, hating both his clients and his own firm's future. Obviously, XX has more bang for the buck.[1]

Some optimists believe there are enough XX-type investments available, and that pension fund selection of such investments is so feasible and would have such beneficial impacts without any impairment of retirement security, that no real dispute exists between traditional prudent investing and advocates of alternative divergent investing.

Whether I am a pessimist or a realist, I fear that more than a failure of communication underlines the dispute here. The controversy is genuine because, for one reason, not all advocates of divergent investing will settle for XX-type investments, since by definition such investments can meet market levels of return, and some advocates' whole point is that there are worthy needs which cannot meet market tests and therefore should be subsidized by the deepest pocket available, pension assets.

Of course the market system leaves some worthy needs unsatisfied, and I agree that many of these needs warrent government intervention. I am not one of those who believes that markets provide the best answers to all problems, except the three obvious needs for collective action — traffic lights, an army and subsidy to my own business.[2]

But not only do I believe that tapping pension assets for hidden subsidies to further other goals is an especially ineffective way to pursue those other goals, more importantly, I reject any divergence from protection of retirement security.

Even with the moderate advocates of divergent investing, who also reject any impairment of retirement security but believe the true path is to pursue what I have labeled XX investing, there are real differences and not merely poor communications. For XX investing is so obviously desirable that it must suffer some hitch or it would sweep the field on its own, without advocacy.

There are a number of obstacles to be overcome before we get to the happy state in which all funds so inclined can buy as much as they wish of XX investments, which actually promote alternative goals without subsidizing those goals at the expense of the retirees, or the pension sponsors, or both. The various difficulties of implementing any divergent investing include which goals shall be pursued, what is the priority among them and who decides.

After hurdling these obstacles, one comes to the problem of identifying which investments have the desired something extra, conflicts of interest between the fund and the "target" of the divergent investment, measuring how well the investment contributed to the divergent goal and trying to ignore the contribution to that other goal while evaluating how the investment performed for the pension fund, lest the exclusive primacy of retirement security begin to erode.

These problems of implementation, considered fully below, are reminiscent of the old cartographic problem of mapping Utopia, which is described as an incomplete circle of 50 miles in circumference with a width of 200 miles,

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Schotland attended Wadham College, Oxford, England, and is a graduate of Columbia College and Harvard Law School. He has served as associate dean at Georgetown Law School, chief counsel for the S.E.C.'s Institutional Investor Study, professor of law at the University of Virginia and law clerk at the U.S. Supreme Court.

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"While it might be possible to draw a non-Euclidean map of Utopia . . . no one has done so, even though many of us do not like the shape the world is in."

— Roy Schotland

a combination not permissible in Euclidean space.

While it might be possible to draw a non-Euclidean map of Utopia, an obvious course, no one has done so, even though many of us do not like the shape the world is in. Implementing divergent investing may seem equally feasible until tried. It is just like Will Rogers' formula for getting rich in the stock market: "Buy a good stock and hold it 'till it goes up, and then sell it. If it don't go up, don't buy it."

A Bit of History

Before focusing on the basic objection to divergent investing and the various implementation problems that limit even XX investing, we should note the history of this idea, for it not only gives us a sense of context, but, unsurprisingly, brings out several of the most important points at the outset.

Ten years ago, Wright Patman was pushing a bill to require private pension funds to invest as much as 2½ percent of their assets *each year* in low- and middle-income housing. Congresswoman Martha Griffiths chaired Joint Economic Committee hearings to explore whether pension funds should be directed by law into "socially responsible" investments.[3]

While the federal scene since has been free of this debate, there are recurrent proposals, some with pressure behind them, aimed at state and local pension funds.[4] But the earliest, most complete and most illuminating bit of history comes from one state.

The earliest explicit advocacy of divergent investing was in 1931 in Wisconsin, when a state assemblyman proposed to have the state teacher's retirement fund emphasize investment in Wisconsin farm mortgages. The assemblyman said that the fund's board had "more confidence in the Dominion of Canada, Puget Sound and God knows where than in the state of Wisconsin."

Further inquiry revealed that although the fund's 10-year losses on farm loans had been less severe than their losses on bonds (remember, this was 1931), the number of such loans had been reduced. In 1932, the Democratic candidate for governor pledged to "wrest control of the state investment board from big business and replace it in the hands of the people to be operated for the public good."

That candidate won, and a bill was passed mandating that at least 70 percent of trust monies be invested within Wisconsin. It specified preference for small loans on improved farm property, loans to cooperative and mutual organizations, and town mutual insurance company mortages, in that order of priority.

That statute mandating in-state preference was repealed in 1945. As admitted by a recent report advocating resurrection of such treatment, "the performance level of the Wisconsin portfolio may have had a bearing on the (repeal) . . ."[5]

In 1949, investment of state funds again became a major issue, and a study commissioned by the governor revealed that the state still was not performing as well as private investment managers with funds of similar size, because the state's investment policies still were not sufficiently diversified. By 1951, a major overhaul of the retirement fund structure was in place, including a great increase in investment flexibility.

For me, this bit of history makes seven points.

First, divergent investing is not a new notion, but one which has been around and around, and its almost complete rejection in actual practice says much.

Second, divergent investing is, in fact, hardly worth the effort to get it into place if it involves picking merely the limited number of what I call "XX-type" investments. The effort is likely to be aimed at using pension assets to subsidize other goals.

Third, subsidizing other goals costs money and the pension fund will perform less well.

State and Local Funds

Fourth, the funds most vulnerable to divergent investing are the state and local funds. They combine political vulnerability with unusually large assets, making it more worthwhile to bring pressure on them. New York's and California's public funds alone exceed $35 billion in assets. The top 25 public funds hold $99 billion, in contrast to the other group vulnerable to pressure for divergent investing, Taft-Hartleys, where the top 25 hold $11 billion. If private pension professionals care about this issue, they will not lie back while their state and local funds — in which they have interests as taxpayers as well as professionally — are pressured into diverging from protection of retirement security.

Fifth, divergent investing is likely to be tried here and there, now and then, until the lesson is learned that this is just one more situation proving there is no free lunch.

Sixth, injecting divergent goals into traditional pension investing is likely to follow the Law of the Austro-Hungarian Generals: "Always fight the last war, aiming with the perfect accuracy of hindsight." The unmet social needs which are likely to be injected into the pension program are inescapably those which have been around long enough to build up a constituency, and by the time they succeed in diverting the pension investment strategy to trying to do what should have been done openly and directly by some other instrument at some earlier time, the odds are high that needs have changed, markets have

changed, and so there is even less likelihood of the divergent investment's accomplishing its divergent goal, whether or not it imposes lower return on the pension fund. Vulnerable as are investment professionals themselves to this same Law of the A.-H. Generals, far better to maximize flexibility and prudent professionalism than to inject and preserve the war cries of fading causes.

Seventh, if and when divergent investing is tried, two safety factors must be put in with it: (A) Use only a modest portion of the assets, not all. If in fact the program does work, despite my analysis of all the reasons it won't, then the assets so used can always be increased. If it doesn't work, the lesson is learned at a much lower cost. (B) Do not reduce investment flexibility. As the recent Wisconsin report advocating divergent investment acknowledged, "A major drawback to this approach (of statutorily defined priorities) is that it might reduce the (state investment board's) flexibility in making investments. To be held to even semi-rigid guidelines laid down by statute could result in an inability to act prudently in times of economic change."[6]

". . . if and when divergent investing is tried, two safety factors must be put in with it . . ."

Divergent Investing's Advocacy

If divergent investing really won't work, and if its advocacy keeps coming up but takes hold in practice little if at all, why not ignore it? Because, for one reason, to the extent that divergent investing is tried, it is too likely to impair investment performance, and therefore impair retirement security, or the fiscal health of the fund's sponsor, whether public or private. Efforts to avoid such impairment seem to me part of the fiduciary's obligation.

For another reason, even debate over this issue is an unproductive distraction from the real issues and tasks of the pension world; the simple ones like improving communications to participants, improving investment managers' reporting of their performance results and making governance of pension funds more representative; or the tough current challenges like coping with inflation, coping with unfunded liabilities, deciding how to provide multi-employer plans with termination insurance, improving private pension benefits' intergration with Social Security so that we avoid a tax-subsidized private pension scheme providing benefits mainly to upper-income people who least need such subsidy, and bringing local pension plan norms into the modern era.

The sooner we do the educating necessary to put the divergent investing issue back on the shelf, the sooner we get back to problems needing much analysis and generating such controversy as to merit all the energy we can bring them.

Advocacy of divergent investing won't stop unless the notion's unreality and unsoundness are made clear. One force raising the issue is that it does sound so attractive — "all other things being equal, why not invest for other goals as well as retirement security?"

It takes some familiarity with finance to understand just how fallacious a notion this is, and neither familiarity nor sympathy is increased when pension professionals respond with various neanderthalisms, such as "we must pursue only financial returns," or "we must protect the solvency of the fund,"[7] as if the fund mattered more than its beneficiaries, or as if the beneficiaries' only concern is financial return. Pension professionals must muster more patience and more persuasiveness to meet the wholly sincere concerns which produce much of this advocacy.

Importantly fueling this advocacy is the hope to get around the clash between the need to meet our society's problems and the limited resources available to meet them.[8] At least since 1973, when the sheiks of Araby took revenge for the 19th Century (to use Giscard d'Estaing's immortal phrase), our economy is not growing as it had for the prior generation, and slower growth means more scrapping over who gets how much.

Pension assets are so huge — over $400 billion, not counting federal pensions — they are bound to be visible, bound to seem an available resource and bound to seem ever more ripe for tapping as they grow faster than almost any other sector of the economy.

Private pension assets are rising more than 10 percent each year and state and locals are increasing 12-15 percent annually.

Third Force

A third force fueling this advocacy is the sad truth that traditional prudent pension investing has not done well at winning those financial returns which, it is argued, must be the exclusive concern if retirement security is to be protected. Everybody knows that our economy, and therefore our securities markets, have done poorly in recent years. But the mediocrity of pension investment performance cannot be so easily excused.

Before considering the striking inferiority pension fund performance data reveal when compared to mutual fund performance data, three points must be noted. First, the data below are limited to equity performance only. All mutual funds combined hold only about 10 percent of their aggregate assets in fixed-income securities, not counting money market funds and municipal bond funds.

Therefore, it seems meaningless to compare total portfolio performance and immaterial to compare fixed-income performance.

Second, one of the main themes in the art of argument, whenever confronted by any comparison, is to stress how many differences exist which undercut the comparison. But if the comparison shows a substantially greater difference than would have been expected (or, depending upon what point the comparison is being used for, if it shows a greater similarity), then the comparison's point must be met head on. The data may need adjustment and explanation, but they cannot be explained away.

Of course, the data below have limits, as noted in the lengthy footnote to the chart, but the performance differential these data reveal overrides any "corrective" adjustments.

Third, the inferiority of pension fund performance revealed here is confirmed by two new, but thorough and fair, studies done by mutual fund professionals and based on neutral data sources.[9]

Noting how inferior has been pension fund performance and speculating about the causes of such inferiority is only a point in passing in this paper, even if it is a point so important that the paper probably would be unnecessary if pension funds had performed well. But the need for research into

Table 1

Historical Risk Premium Evidence, Annualized 10-Year Rates of Return

Ten-Year Time Period	S & P Bond Index	25% Stocks	75% Stocks	S & P Stock Index
1900 Through 1909	4.5%	5.9%	8.3%	9.3%
1901 Through 1910	4.3	5.2	6.5	6.9
1902 Through 1911	4.2	4.7	5.4	5.4
1903 Through 1912	4.2	4.7	5.3	5.3
1904 Through 1913	4.3	5.1	6.4	6.8
1905 Through 1914	3.8	3.9	3.7	3.4
1906 Through 1915	4.0	4.3	4.3	4.2
1907 Through 1916	4.4	4.7	5.0	5.0
1908 Through 1917	4.1	4.6	5.5	5.7
1909 Through 1918	3.6	3.8	4.0	4.0
1910 Through 1919	3.1	3.5	4.1	4.3
1911 Through 1920	2.9	3.1	3.2	3.1
1912 Through 1921	4.0	4.1	3.9	3.7
1913 Through 1922	4.6	5.0	5.5	5.6
1914 Through 1923	4.7	5.4	6.3	6.6
1915 Through 1924	5.1	6.4	8.7	9.7
1916 Through 1925	5.1	6.3	8.3	9.2
1917 Through 1926	5.2	6.4	8.6	9.5
1918 Through 1927	6.5	8.8	13.2	15.3
1919 Through 1928	6.1	9.2	15.0	17.7
1920 Through 1929	6.4	8.7	12.8	14.6
1921 Through 1930	7.0	8.9	12.0	13.2
1922 Through 1931	5.2	6.1	6.7	6.3
1923 Through 1932	5.1	5.2	4.0	2.8
1924 Through 1933	5.7	6.7	7.2	6.7
1925 Through 1934	6.3	6.5	5.4	4.0
1926 Through 1935	6.6	7.2	6.7	5.7
1927 Through 1936	6.6	7.7	8.2	7.6
1928 Through 1937	6.2	5.6	2.6	0.1
1929 Through 1938	6.6	5.6	1.9	(0.8)
1930 Through 1939	6.8	5.9	2.5	(0.1)
1931 Through 1940	6.5	6.0	3.6	1.6
1932 Through 1941	7.0	7.3	6.8	6.0
1933 Through 1942	6.3	7.5	8.8	8.9
1934 Through 1943	5.7	6.5	7.0	6.8
1935 Through 1944	4.9	6.3	8.4	8.9
1936 Through 1945	4.4	5.7	7.6	8.1
1937 Through 1946	3.9	4.4	4.6	4.2
1938 Through 1947	3.4	5.1	8.0	9.2
1939 Through 1948	3.2	4.3	6.1	6.8
1940 Through 1949	3.3	4.8	7.5	8.6
1941 Through 1950	3.1	5.7	10.5	12.7
1942 Through 1951	2.5	6.2	13.1	16.5
1943 Through 1952	2.4	6.0	13.0	16.3
1944 Through 1953	2.4	5.4	10.9	13.6
1945 Through 1954	2.4	6.1	13.1	16.3
1946 Through 1955	1.9	5.7	12.7	16.0
1947 Through 1956	1.1	5.4	13.7	17.7
1948 Through 1957	1.9	5.6	12.6	15.9
1949 Through 1958	1.1	6.0	15.2	19.5
1950 Through 1959	0.3	5.3	14.6	18.9
1951 Through 1960	1.0	5.1	12.5	15.9
1952 Through 1961	1.6	5.6	12.9	16.2
1953 Through 1962	2.1	5.3	10.9	13.3
1954 Through 1963	2.0	5.8	12.7	15.7
1955 Through 1964	1.9	5.0	10.3	12.7
1956 Through 1965	1.9	4.4	9.0	11.0
1957 Through 1966	2.5	4.4	7.7	9.1
1958 Through 1967	1.3	4.4	10.1	12.6
1959 Through 1968	1.6	3.9	8.0	9.8
1960 Through 1969	1.1	2.9	6.2	7.7
1961 Through 1970	1.6	3.4	6.6	8.0
1962 Through 1971	2.0	3.4	5.9	6.9
1963 Through 1972	1.9	4.0	7.9	9.8
1964 Through 1973	1.9	3.0	5.1	5.9
1965 Through 1974	1.3	1.5	1.5	1.2
1966 Through 1975	2.3	2.8	3.3	3.3
1967 Through 1976	3.7	4.7	6.1	6.6
1968 Through 1977	4.5	4.5	4.0	3.5
1969 Through 1978	4.6	4.4	3.7	3.1

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this point, to explain why pension funds have suffered such inferior performance, is as irrefutable as the data themselves. (Chart 1)

For the purposes of this paper, suffice it to say that no refutation of divergent investing could be as convincing as strong investment performance via traditional prudent management. Unless and until we get such performance, we must argue, and from a defensive posture.

For purposes of argument against divergent investing, some pension professionals think the best answer goes along these lines: "First, get the participants to agree to change their plans from defined benefit to defined contribution so that the risk of any lower investment returns is borne wholly by the participants."

That, however, merely is a debater's point, since such a change is not readily made and we will not remove interest in divergent investing by debater's logic, but by demonstrating what works and what does not. We need research on the reasons for poor pension fund performance, and we need to take steps toward improving performance. Mediocre investment performance by the private pension system exposes it to arguments against traditional prudent investing, and even calls into question the justification for having a private pension system.

Even if the exclusive pursuit of investment returns had been more successful than it has been, the less that people know about investment the easier they find it to look back and say how clearly it would have been done better if it had been done differently. I am aware of no line of activity in which success and failure are so explicitly revealed as investment management. Today many second guessers scoff that savings accounts have done better than the stock market over so much of the last decade, and they are correct as far as they go. But how many such scoffers called any turn in advance?

". . . many . . . scoff that savings accounts have done better than the stock market . . ."

Their advice now may be as helpful as was the Ford Foundation's in 1968 when they urged university endowments to abandon as obsolete their conservative investment policies and instead enjoy the greater benefits of growth-stock investing, just as events were making that advice one of the worst strategies of all.

The fallacy of this hindsight is compounded by two errors in the advocacy of divergent investing. For one, today's relatively high yields on, say, inter-city mortgages are compared with actual, total investment returns over the last decade. But the 5-percent mortgage of as recent times as 1961-62, or the 7- to 8-percent yields of 1971-72 are ignored.[11]

Similarly ignored are the investment returns of the 1960s, or of the past 20 years, or the comparison between fixed-income returns and the returns on equities.[12]

How do we know whether the next

decade's total returns from traditional prudent equity investing (using the S&P 500 as a proxy) will average an annual rate of 3.1 percent as in the decade 1969-78, or instead the 9.8-percent result of the previous decade, or instead the glorious 19.5 percent per year of 1949-58, or instead results like one of these periods: 1967-76, 6.6 percent; 1965-74, 1.2 percent; 1958-67, 12.6 percent; 1954-63, 15.7 percent? (Table 1 & Chart 1)[13]

Indeed, of the 70 different 10-year periods from 1900, stocks outperformed fixed-income investments (using as a proxy the S&P high-grade corporate bond index) in 58 periods and underperformed in only 12. Seven of the 12 periods in which stocks underperformed were the Great Depression, but three of the remaining five poor periods were 1965-74, 1968-77 and 1969-78, and that recent experience is all some people think of.

Are those who would choose divergent investing over traditional prudent investing so determined to abide by the Law of the Austro-Hungarian Generals, is their hindsight so hampered by blinders, that they look exclusively at the immediate past and ignore the rest of our experience?

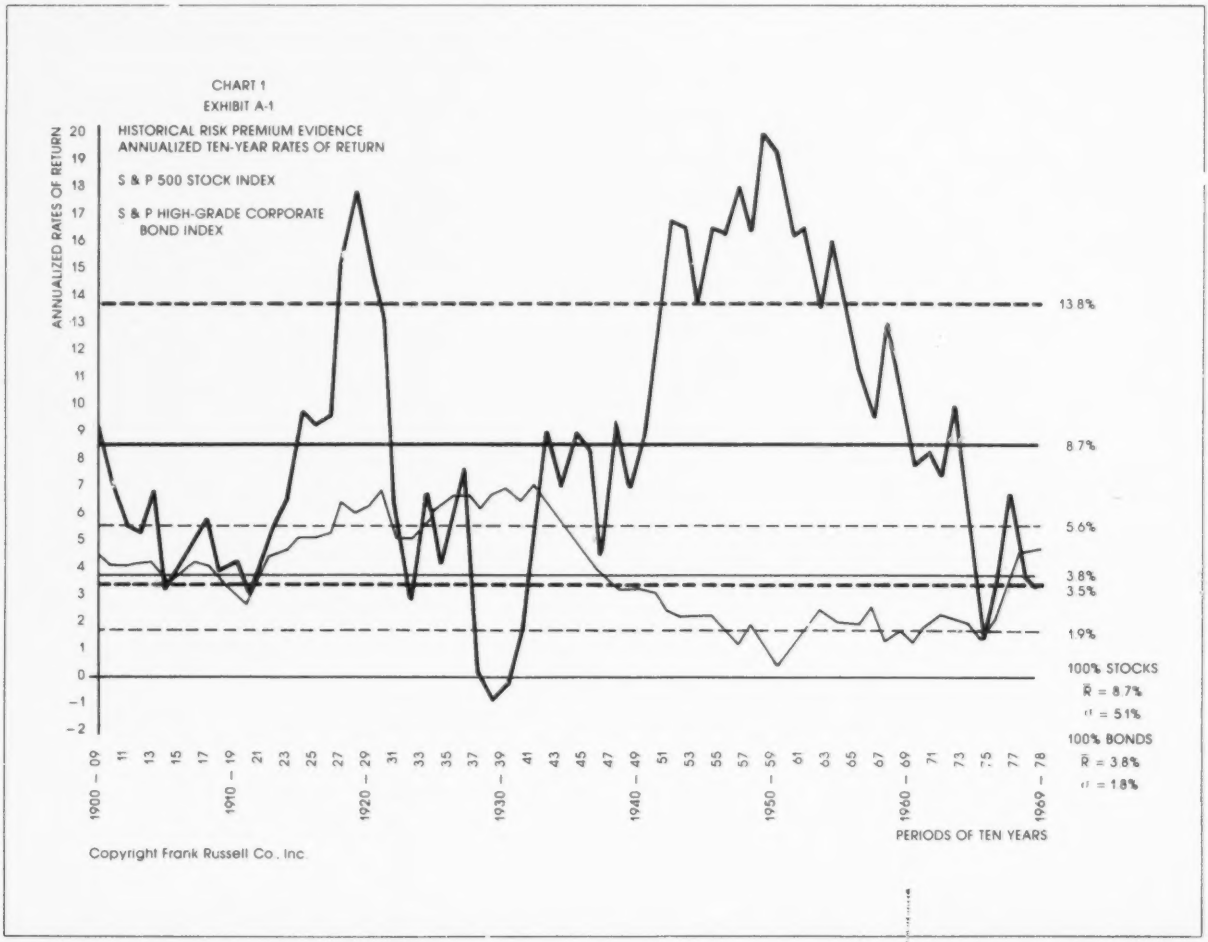
Are people who are so ready to abandon traditional prudent investing so sure of what the future holds that they assume inflation will vanish, or that prudently chosen equities will lose their superiority as an investment defense against inflation? From 1900-1978, the inflation-adjusted annualized 10-year rate of return on stocks has been 6 percent. The rate of return on fixed-income investment, again adjusted for inflation, has been only 1.3 percent. (Chart 2)[14]

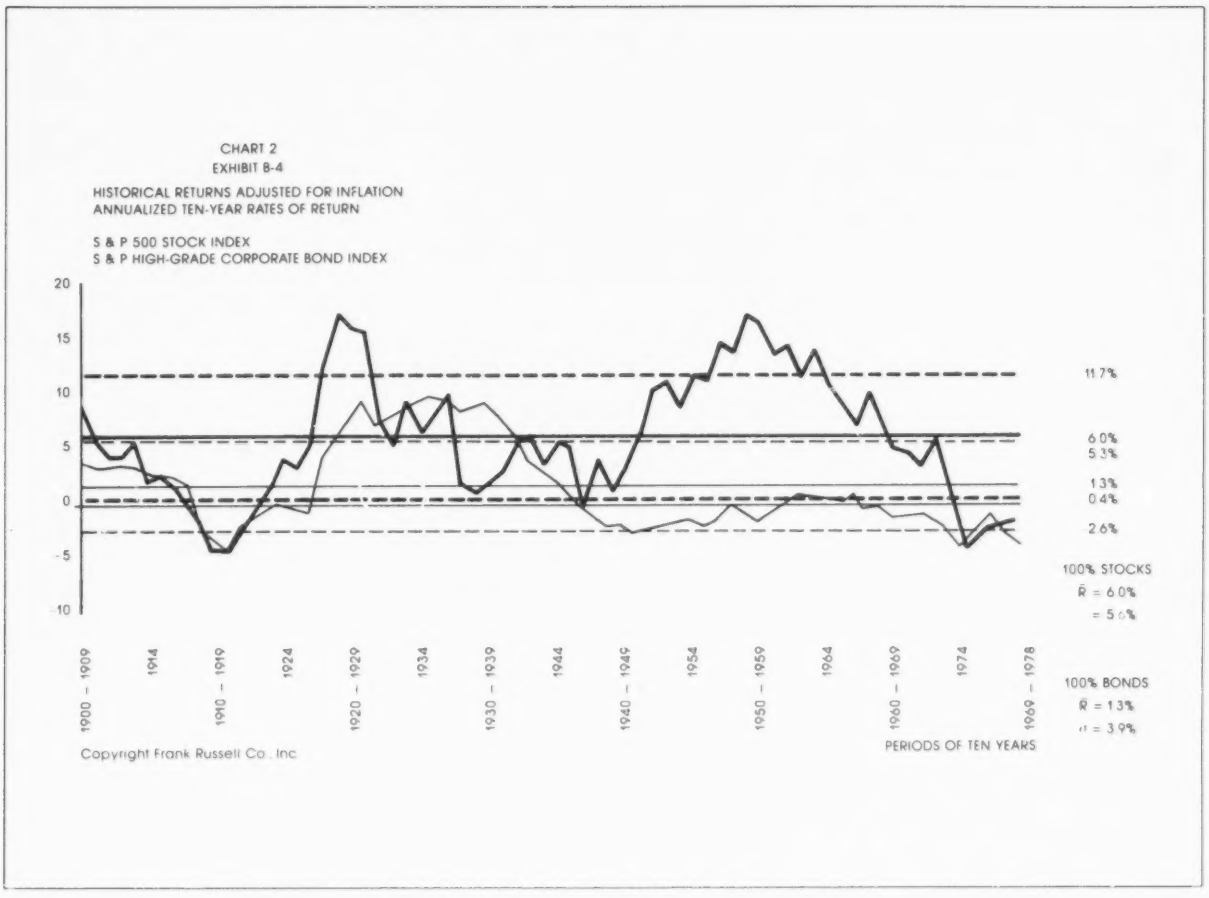
". . . Will Rogers said he was not as concerned about return on investment as return of investment . . ."

In short, advocacy of divergent investing would have less force if facts about traditional prudent investing were not used "selectively."

One other error compounding the smugness of hindsight about how prudent investing has performed is that relative riskiness is ignored. If a total portfolio's return has been, say, 6 percent, that is thought to justify loans to, say, small firms at about that same interest rate. Only a moment is needed for a disinterested observer to see that unless riskier investments earn higher yields to compensate for the greater risk taken and to help build a cushion against the higher number of disappointments bound to occur in that higher-risk area, the whole fund itself soon will be an acute disappointment.

When Will Rogers said that he was not as concerned about return on investment as about return *of* investment (a maxim that ought to be a legally required legend, in large type, on every page of every investment manager's merchandising materials), old Will





didn't mean what the advocates mean.

One final force fuels the advocacy of divergent investing. There always are people who need something to advocate, either because they are in the political arena, or just want to sound off.[15]

I don't fault such people. Political dialog should be wide open, and far be it from me, as a law professor, to be so graceless as to condemn others for seeking a podium. But not all divergent investing advocates are blameless. Some of them are hypocrites, urging that other people's funds be exploited in ways they wouldn't dream of allowing for their own.

I regret that the outstanding example of such hypocrisy involves the secretary-treasurer of a union, since I am pro-union and consider the Amalgamated Clothing and Textile Workers one of the finest in many ways. But how can we ignore the following contrast between advocacy and practice?

The advocacy:

"There are billions of dollars in the state employees' pension fund. Clearly these monies can be invested in any number of ways to secure an adequate rate of return. The best interests of the system's beneficiaries, however, extend far beyond the mere rate of return.

"Investment capital provides the necessary dollars for economic growth and development. The range of opportunities to deploy capital is broad, and the billions of dollars in the New York State Fund can have tremendous impact wherever those dollars are directed. We need to seriously consider these directions.

"Profitability cannot be the only criterion. Where are these investment dollars reinvested after they leave our hands? How much of the property on which the fund holds mortgages lies within New York State? How many of the corporations whose notes or stocks we hold conduct most of their business inside of New York? Each dollar invested in an enterprise outside of this state diminishes our efforts to create jobs and economic growth right here.

"We should demand to know why our pension fund invests in an office building in Washington, D.C., or a military base (?) in Kansas. The same rate of return can be found in numerous other investments without the same ultimate economic cost to our state."

"There always are people who need something to advocate . . ."

And here is the investment practice of that advocate union's pension fund, with assets of $237 million.

Of that $237 million, $4 million is in mortgages, $5 million is in insurance company guaranteed contracts, a tiny $800,000 is short-term, and the remainder has been invested — for so long that memory runneth not to the contrary — in U.S. government securities with five to 10-year maturities. (As one major trust department officer said, even more surprised by those maturities than by the portfolio concentration, "They're right-wingers. They don't even trust the government!")

Within recent months, that fund de-

cided it should utilize more fully the "broad range of opportunities to deploy capital," so it started modest acquisitions of GNMAs! Not even if that portfolio satisfies ERISA requirements of prudent diversification (and I am certain it does not, even though no court might be willing to hold trustees liable for investing exclusively in U.S. government securities), surely anyone involved with such a portfolio ought not advocate that other people's retirement security be jeopardized by indulgence in divergent investing. Never have I seen so literal an example of great distance between where the money is and where the mouth is.[17] □

FOOTNOTES

1. Use of the symbol "XX" is not meant to imply that such an investment has twice as much "bang," merely that it does have something extra.

Lest there be quibbling over what is the most accurate label in this discussion, I proposed at the EBRI discussion on December 6 that we use (1) "T" for traditional investing; (2) "XX" for what I call moderate divergent investing or what James Hutchinson refers to as "socially sensitive" investing (which troubled both Jeremy Rifkin, coauthor of *The North Will Rise Again*, and me); and (3) "X" or the recent favorite all-purpose label, "banana," for any investment which accepts possible or probable lower returns or higher risk.

In fact, I believe the "divergent" label is precisely accurate, and its accuracy accounts for its potency in piercing the euphemistic "social" label.

2. See my opening to "The Deregulation of the Banking and Securities Industries" (eds. Goldberg & White), *An Overview: New Myths and Old Realities*, (D.C. Heath, 1979).

3. See my testimony in Hearings on Investment Policies of Pension Funds, before Joint Economic Committee, Subcommittee on Fiscal Policy, 91st Cong. 2d Sess. (April 1970), pp. 110-34.

4. Starting last year, an inter-agency study led by the Department of Housing and Urban Development, being carried out by the Urban Institute and Municipal Finance Officers Association, includes an inquiry into state and local practices, law, and pressures related to alternative investing.

5. Wisconsin Center for Public Policy, *Investment Targeting: A Wisconsin Case Study* (1979), at 121. The remainder of this history, curiously omitting mention of the repeal, is at *id.*, pp. 16-17.

The report's advocacy of another try is a triumph of hope over experience. The study itself cost $180,000.

6. *Wisconsin Case Study, supra*, at 238.

7. Whether or not such "answers" are as neanderthal as I say, they reflect a deeper problem noted by Daniel Moynihan: "The difficulty is simply that a mind attuned to the market place acquires an almost trained insensitivity to nonmarket considerations." From his Arthur K. Solomon lecture, New York University School of Business, Apr. 29, 1971, p. 43.

8. A regional problem has been used as the fulcrum of a recent book devoted to divergent investing, the catchily-entitled *The North Will Rise Again*. As was said by a friendly reviewer in a friendly journal (Matt Witt, former editor of the *UMW Journal*, writing in *The New Republic*, Sept. 16, 1978, pp. 22-23), "This is not a book which should be judged on the fine print." A few examples and points should suffice to show that however noble the authors' goals, their work has such carelessness, inconsistency, and penchant for lamentation rather than analysis, facts, or prescriptions, as to render the book a disservice to its own cause.

(1) The main cry of the book is for union pension funds in "Graybelt" states to start investing locally. No attention is paid to: (a) What will happen if funds in the area growing more rapidly in wealth, the "Sunbelt," start pursuing the same policy? (Interestingly, earlier this year an investment management firm in Houston started offering a "Sunbelt Index Fund," based on data showing that equity investment there has considerably outperformed other equity investment.) (b) What will happen to Graybelt pension fund beneficiaries if their local investments perform poorly, or even just less well than more national (or international) investments? (c) Would such indirect support to the Graybelt economy be effective at all, let alone as effective as more direct steps such as regional development banks, ESOPs, pooled investment in inner cities, etc.? (d) To what extent are the problems of the Graybelt not even the result of capital shortage, but rather of a secular transition of the older part of the nation, a problem already enjoying substantial self-connection? (e) Don't the interests of marginal current workers, who might benefit from non-economic local investments, diverge from the interests of retirees and others who have vested stakes in the pension funds?

In response to concerns this book prompted among four Congressmen in the Northeast-Midwest Coalition, the Northeast-Midwest Institute did "research to analyze whether or not these claims [that their region is being "redlined" by pension fund capital] can be substantiated." The study concluded "that the above claims, on their face, are simplistic and misleading. The more accurate observation is that key factors such as relatively high costs of labor, land, transportation and energy have helped make the region less competitive." Anne Kaufman, *An Analysis of Current Issues in Pension Fund Investment Practices* (April 1979), p.1.

Thus even a source highly sympathetic to seeing "the North rise again," finds the book fallacious. Coming to the same conclusion after full economic analysis is George J. Borgas, *Union Control of Pension Funds: Will the North Rise Again?* (Inst. for Contemporary Studies, San Francisco, 1979).

Since it is not this paper's purpose to refute fantasy about regional economic cycles — by examining, e.g., such differences within the "North" as New Hampshire's sharp rise in contrast to Massachusett's problems, or why even the latter are turning around — the above references, citations therein, and the recent state-by-state study by Chicago's Harris Bank economists Genetski and Chin, should suffice.

(2) The book rests on the premise that our Federal union, with free flow of people, goods, services and funds throughout the nation, is less desireable than a Balkanized America. Not weighed and found wanting, but rather that the book ignores such facts of life. I'm with the majority who do not want to resurrect the Articles of Confederation.

(3) The book is closer to dream than reality. For example, the State of Pennsylvania did take special steps to aid the location there of a new VW assmbly plant. The book grossly overstates the state aid involved (the alleged $135 million loan is over two times the actual aid), and grossly understates the gain: "a measly 2,000 to 5,000 private-sector jobs." (p. 173).

(4) The book is strikingly slipshod. It says the generations-old "prudent man rule" is a "new term" introduced by ERISA, the 1974 Pension Reform Act (p. 102) and it cannot decide whether the funds it is discussing amount to $500 billion (p. 10), $406 billion (at book, or $438 billion at market, p. 234), $200 billion (pp. 10, 81), or $125 billion (p. 236).

(5) The book is so inconsistent as to be at war with itself. For example, it laments use by corporate pension sponsors of their pension assets for their corporate goals, but applauds state or local government use for governmental goals. State and local employees who are the beneficiaries of their employers' plans are evidently less worthy of concern than corporate employees. One of the clearest examples of the book's "wanting-it-both-ways" is this:

"Take, for example, the Wisconsin State Life Insurance fund. Founded as a self-supporting state-owned business in 1911, this insurance company provides Wisconsin residents with the least expensive life-insurance costs in the United States. . . . This incredible difference is partially a result of the fact that the Wisconsin Fund has such a small overhead compared to private insurance companies. Because it has no advertising costs and no sales commissions to pay out, its administrative expenses are virtually zero compared to industry giants like Prudential. Unfortunately, because of a strong lobby by the private insurance industry over the years, the fund has been unable to expand its mandate to cover larger premiums and to diversify into other insurance areas. As a result of that and its legal restrictions on advertising and solicitation, it has remained small." (p. 203).

9. John C. Bogle and Jan M. Twardowski, "Comparative Equity Investment Performance: Banks, Investment Counselors, Insurance Companies and Mutual Funds," forthcoming publication in *Financial Analysts Journal;* Investment Company Institute, Perspective on Mutual Fund Activity, Rpt. No. 4, Oct. 18, 1979, at 35-36, and ICI Associate Economist Jos. F. Sumanski, A Performance Comparison of Mutual funds and Bank-Pooled Funds, Nov. 21, 1979.

10. First, some of the data warrant explanation:

(1) It is unusually difficult to beat the S. & P., for many reasons not pertinent here. The point of Comparison A is rather how very wide is the margin between the pension funds and the mutual funds.

(2) The CDA data are annualized rates of total return, not the total return over the full 3-, 5-, or 10-year periods; and they are not medians but unweighted means.

(3) The "risk adjusted total return" ("alpha") figure states how good the actual performance was in light of how much, or how little, risk the fund(s) took on as compared to the whole market. The figure is arrived at as follows: "Riskless" return is the return on Treasury bills. If T-bills' total return was 8.6 percent for the year 6/30/78 to 6/30/79 (as it actually was), then that 8.6 percent is compared to the total return on the S. & P. 500 (as the proxy for the whole market) in order to derive the "market risk premium" an investor in equities received for taking on more risk. (In a bad year, the risk "premium" can be negative.) Thus since the S. & P.'s total return was 13.5 percent for 6/30/78 to 6/30/79, the "market risk premium" was 5 percent (actually 4.96 percent, the earlier figures being rounded).

If a fund or group of funds took on no more risk than the market generally (to state that in terms of one numerical measure, a "beta" of 1.0), the fund(s) would underperform or outperform the market simply by securing a total return under or over the market's. But if the fund(s) took on, say, ⅛ more riskiness than the market (a beta of 1.125), then the fund(s) should enjoy ⅛ more "risk premium" than the market's. Thus if the market as a whole returned 5 percent more than T-bills, the ⅛-riskier fund(s) should have a risk premium of 5.625 percent, or for 6/30/78 to 6/30/79, a total return of 14.225 percent.

Since the CDA equity mutual funds were ⅛ riskier than the market but had a total return of 15.6 percent, they exceeded by 1.375 percent their expected reward for the riskiness they assumed. On the other hand, the CDA bank pools, which took on only 95 percent as much risk as the whole market, were expected to have a "risk premium" of 4.75 percent above T-bills, or a total return for 6/30/78 to 6/30/79, of 13.35 percent. Since in fact those pooled funds returned only 13.0 percent, they had a negative risk-adjusted total return of 0.35 percent.

(4) The CDA bank pools are not under as great diversity of management as the Becker universe. Similarly, the Lipper group of mutual funds are probably more diverse, in terms of kinds of managements involved, than the earlier Becker groups, since such large portions of the latter were managed by a relatively small number of huge bank